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DISCUSSION OF CONTRIBUTION THE UNITED STATES MAY MAKE TOWARD IMPROVING THE EUROPEAN SITUATION

I

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Mr. Chairman, Ladies and Gentlemen: I feel that it is presumptuous in me to attempt in a few moments to discuss so learned a paper as the one you have just heard. Mr. Warburg stands pre-eminent among economists, and everything he says is always listened to with appreciation and a feeling of confidence in the soundness of his ideas.

Dr. Warburg is the highest type of a modern practitioner. He is sane in his prescriptions. He prescribes plenty of fresh air, exercise and a good healthy diet, but I am afraid he may not be entirely popular these days if he does not include just a bit of stimulant. For the condition in which he describes his patient to be, stimulant, I think we must all agree, is necessary.

I was pleased to hear him say that the occasion might arise where we should have to stand more inflation in order to do our duty to Europe. There are many men who do not think deeply on economic subjects and who become impatient at times with fundamental economic principles (and we meet a great many of them nowadays). These men say: "Why can not this country with its 250 billion dollars of wealth, owning 40% of the gold supply of the world, establish the credits that are needed in Europe? Why do we hear this continuous talk of deflation when the rest of the world is inflated and world deflation must necessarily extend over a long period of years?"

There is a feeling of impatience among a good many men with whom you talk about the policy of drastic deflation which has been adopted in this country where we have suffered so slightly from the ills of the war. It is said very frequently: "Why is it necessary to keep our gold reserves at 40%? What is a reserve for if it is not to be used in times of stress? Why do we have 8 to 15% call money in the United States, and London reports 4 to 6%? Why do we penalize the development of our industries these days by these high

money rates when that penalization will act as a burden on these industries for years to come? Why arbitrarily attempt to depress and restrain industry."

To those who argue along this line I recommend a very careful study of Mr. Warburg's paper. He answers these questions quite conclusively, and in answering them stands on sound economic ground. The one fundamental thing which so many people overlook is that credit must be based upon wealth, and that to be in a position to grant credits to Europe we must produce, save and create new wealth which will serve as a basis for credit. Where we have an excess of raw materials without the labor, then sound economics and sound business require that where the labor cannot be brought to the materials the materials should be brought to the labor.

Every European country today is asking for credit. We may look at this question in a broad international spirit from a world viewpoint, or we may look at it purely from a selfish American standpoint and our conclusions must be the same. From the world view the sooner these countries in Europe obtain the raw material and the means of production the sooner they can produce and add to the world's wealth. We have all read the stories of suffering in Poland, and of the new nations that have been developed out of Russian and Austrian territory. We have had vividly pictured for us the conditions in Germany and Austria, but somehow we do not seem to appreciate the critical nature of things on the other side. We know that there are millions of our fellowmen willing to work, but with no tools, no raw material and nothing with which to work, and we know that as a result of the lack of material and tools they are subsisting on starvation rations, and each day their condition becomes more hopeless and wretched, and yet knowing and realizing these awful conditions we do nothing.

This brings the problem home from a broad humanitarian standpoint. If we have the cotton in this country we ought to find some way to give Europe the cotton and let them manufacture it. Our government, however, has apparently washed its hands of the whole affair. Our politicians in Washington debated the Treaty for months, and nothing constructive resulted from that method. As a nation we have apparently said to Europe, "This government cannot help you, you must look for assistance to the bankers of the United States," and I say to you, ladies and gentlemen, that the problem is too big for individual bankers to handle, no matter how powerful or how able they may be.

If we look at this matter from a purely selfish standpoint, if you will, we must reach the same conclusion, that some scheme of granting credit must be worked out in order to again build up the buying power of Europe and develop and maintain permanent markets for the excess production of this country.

Statisticians tell us that before the war the United States had an excess manufacturing capacity of 30% ; in other words, we were capable of producing 30% more than we could consume in this country. 1913 saw the beginning of a national movement in aid of the policy of the extension of our foreign trade. A foreign trade council was formed about that time, and as a result of the pressure of American manufacturers Congress provided in the Federal Reserve Act for the establishment of branches of American banks abroad. American manufacturers began to study the problem of foreign markets, and the beginning of the war found the country organized for foreign trade.

During the war our industrial capacity has still further increased. It is generally estimated that this increase has been at least 25%. At the present time production in this country, as everywhere in the world, has not kept pace with the demand, but the demands for goods are unusual and abnormal. During the war people had to deny themselves everything. Production in all lines was restricted, and the entire industrial activities of the country were directed toward producing the goods that were needed in winning the war. When the lid was lifted and the days of sacrifice apparently over every one again began to purchase what he wanted, and everybody wanted everything that he hadn't had for two years and wanted it at once. The result has been that there were two or three purchasers for everything, and the holder of the goods was able to exact his own prices.

When the edge of this insistent demand is dulled and we get back to a more normal basis where our production will exceed the natural consumption demands of the country, where will we sell our surplus products? Where will be the customers with buying capacity? Our greatest market before the war was Europe. The size and permanence of a market depend upon its buying power. People cannot buy unless they have the means with which to buy. These means result from the saving between production and consumption. Unless Europe can be brought back on a producing basis so as to be able to save something with which to pay for goods in the world's markets Europe as a market will be without buying power, and we cannot develop any substantial trade with her.

Looking at the matter, therefore, from a purely selfish standpoint, the industrial prosperity of the United States depends upon rebuilding Europe as a market for our excess products, and this cannot be done unless Europe now is given credit in the shape of tools and raw materials that will enable her to get back to a producing basis.

Up to the passage of the Edge Bill we had no machinery in this country for financing our foreign trade upon a permanent basis. Our system of banking has resulted in the building up of great commercial banks, but these banks are deposit banks obtaining their working capital from depositors. As the great mass of deposits are payable on demand, sound fundamental banking principles make it necessary that these banks remain liquid, and that they do not invest their money in long-time paper. In this position of strained credit conditions every accommodation over three months must really come in the class of long-time paper. In other words, the commercial banks of the country deal in credits, and the conditions of world trade today are such that it must be financed by capital instead of credit. Capital today must be defined to mean any accommodation over six months.

Properly to finance our foreign trade we need to build up in this country a new kind of bank, one that will obtain its working capital from the investors of the country through the sale of its obligations based upon credits granted abroad. This is the character of banking institution authorized by the Edge Bill. To be more specific, the Edge Bill provides for the incorporation under Federal charter of banking associations which are permitted to exercise all the functions of international banks. Their operations are to be under the supervision of the Federal Reserve Board. They may engage in banking operations of all kinds, but are obliged to restrict these operations to international business. They may accept deposits in this country only as such deposits are incidental to foreign business. Subject to certain restrictions, they may accept deposits in foreign countries in so far as the laws of these countries permit them to do so. They may establish branches in all parts of the world, and may own stock in foreign banking associations or foreign banks up to a certain percentage of their capital. They are given very wide latitude in establishing connections abroad for the development of foreign business. The way is thus left broadly open for coöperation with foreign banking interests in any particular country or countries.

In addition to exercising the ordinary banking powers, Edge Bill banks are permitted to issue debentures, notes or other obligations up

to ten times the amount of their capital. The way is thus prepared for the issuance of an obligation of an American banking institution under supervision of the Federal Reserve Board which shall be based upon the security of foreign credits with or without the endorsement of the American exporter, as the case may be. If a market for these securities can be made, and the American investor educated to put his money into investments of this character, then at last we will be able to place America's foreign trade upon a sound basis. Europe needs credits for periods of six months up to three years depending upon conditions in the various countries. No commercial bank can extend these credits. The Government has declined to do anything further. Unless the people of this country, by investments in securities of Edge Bill banks, are willing to extend the credits, the United States will not only lose its great opportunity of laying a firm foundation for future permanent foreign markets, but it will deny to Europe the aid which it has in its power to give, and retard the rehabilitation of those countries whose direst need is credit in the shape of raw materials and working tools to enable them to rebuild and reconstruct their shattered financial and industrial structure.

The Edge Bill has provided the machinery. The question is, have we the leadership and the ability to develop international banks that can do their part in the present emergency? Are the American people broad-minded and far-sighted enough to support this kind of institution? We cannot finance our foreign trade in any other way. England has made wonderful progress since the armistice. Their bankers have a grasp upon the situation, and are getting a hold upon the business of the world. They have the courage and vision to do things. We have been talking and not acting.

The extension of credits, even those credits which are absorbed by the investors of the country, may mean a further inflation, but our supply of gold and the vast fundamental wealth of this country furnish a base for even further expansion where such expansion is necessary to the world's welfare. To extend the needed credits requires that the process of deflation perhaps must be arrested, but we have progressed far more toward deflation than any of the other countries, and if the sound financial brains of England consider it necessary to continue on an inflated basis while the credits are granted for the purpose of rehabilitation, is it not possible that we might to advantage follow their leadership? May we not be making a mistake in taking a stand for too immediate and too drastic deflation when by granting credits to Europe we will be building a foun-

dation for future foreign business which is necessary to the continued industrial prosperity of this country?

It will be a difficult thing to educate the American investor to an appreciation of his opportunities and responsibilities at the present time. Dr. Warburg has pointed out that billions of dollars have been lost in unsound, reckless gambling investments in this country in the last few years. If the money in this country which has been put into wildcat promotions could have been placed in sound foreign investments, and this work could have been organized a year ago, as it should have been, conditions in Europe would not be nearly so serious as they are today. If a year ago intelligent government leadership and help could have been back of such a movement, Europe would have gained much time and been spared infinite suffering.

The people of the United States have a great opportunity. No nation has ever been so thoroughly advertised by its accomplishments. Our feat in organizing and equipping an army of 4,000,000 men, of transporting them to the other side, and developing them into a successful fighting unit has never been equaled in history. At the close of the war we were looked upon as the saviours of Europe and the great nation of the world. Leadership in world affairs was practically conceded to us. Today, because of the mistakes we have made, because of our inability to furnish intelligent leadership in the work of financial reconstruction, and our failure to develop any constructive plans for helping Europe, we have lost much of our prestige. We have been generous with advice, but our friends on the other side contemplating our wealth, our power and our ability along so many lines may well say to us, "why is it that with your vast resources you cannot devise some means to place at our disposal your raw materials, and why can you not work out some sound financial plan that your people will back, so that we may have an opportunity to rebuild our industries and do the very thing you tell us we must do, produce and save, but which we cannot do without raw materials, tools and machinery?"

This country still has a great opportunity, ladies and gentlemen, not only to assure for itself future commercial and industrial prosperity, but to bring back to health and strength a sick and suffering world. We can accomplish nothing by talk, but will do things if the right kind of leadership can be found in this country to point the way, and if as individuals we all charge ourselves with the obligation of doing our part in support of such sound constructive

measures as may be developed. If America will get together to help Europe with the same spirit that it exhibited during the war our friends on the other side will not be disappointed in the ability of the American people to accomplish results.

II

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The hour is so late that I shall condense my remarks and confine them strictly to two chief topics. The first one is suggested to me by Mr. Warburg's reference to what may be called "European Industries on the Bargain Counter," opportunities for investment over there that, given certain conditions, might look very tempting for American capital.

I come to the same idea by a somewhat different route. Scarcely more than a year ago many of us were speculating as to how the European nations were going to go about repaying us the money which we had lent them. I was called upon on various occasions to make suggestions as to the mechanics by which this might be done. Looking back, in the light of present conditions, it is clear that we thought too much about how Europe was going to pay the debts she owed us and too little about how she was going to restore her own industries and get upon her own feet again. But an examination of the various mechanical processes by which her foreign debts might be paid is nevertheless not without profit. The same mechanics which would be required for paying debts must be used for the solution of the more urgent problem that confronts us, the reduction of inflation.

Of course it is impossible to pay great international debts in money. That plan we will reject at once. Usually they are paid by an excess of exports over imports on the part of the debtor country. That is unquestionably the ultimate source of payment, regardless of what may be done on a capital basis. For, looking at a problem of this kind by and large, in the long run it is the movement of goods from day to day and week to week and month to month and year to year that is far more important than the capitalized profit which may flow out of that movement. It is the constant stream that we require; that is what we have to live upon; that gives us our daily bread. There are difficulties, however, in the increase of European exports to the United States or imports by the United States from

Europe. One is, of course, the lack of production in Europe under present conditions, which has been so frequently commented upon today. Another one which I expected to hear mentioned is the fact that our American consumers are not educated to a large consumption of European goods, or of foreign goods. There are many desirable things which the French produce (and we know France perhaps better than some of the other countries) which our people do not know or are not educated to use. Moreover, there are many desirable things produced in other parts of the world which we would be glad to have if we knew about them, and which might come to us indirectly in connection with the discharge of the foreign debts. But there is always a possibility that a debtor who cannot pay from his current production, can pay in property, and so we come back again to the possibilities suggested by Mr. Warburg of buying, or lending upon the security of foreign properties, preferably, of course, properties of a productive character. I confess I don't know how this can be accomplished. We have been absorbing to a very small degree the securities of foreign or European cities, but the purchase of those city securities and bonds has been more in the nature of gambling on the fluctuations of exchange than of any real investment calculated to meet to any extent Europe's immediate need of capital.

What seems to be lacking is any agency that would examine into the soundness of the various investments that might be offered as security and even guarantee them. Whether we would be willing to send capital over there to be secured by mortgages upon various industries depends upon whether we can learn about them, and the means of examination and the dissemination of information now available are entirely inadequate. The linguistic difficulties are an obstacle, and then, of course, sad to say, there is at the present time a still graver difficulty in the lack of confidence we have in the political permanency of governments and the solidity of economic institutions under the present disturbed social conditions.

The other topic that I wish to touch upon is the setting of our own house in order in the matter of national finance, government finance. We have been talking a great deal about budget legislation. Every movement has to have a slogan and a name and sometimes we forget to go behind the name. In my home town some time ago there was an attempt to float some bonds for the purpose of building a new high school. The canvassers went about the city asking, "Are you in favor of bonds?" If you asked them what bonds,

they would say, "Just bonds." So a good deal of our agitation for a budget has been along the same lines, and the man who questions what kind of a budget is apt to be looked upon as a strange creature.

Now there are a great many different budget systems. A European budget system, based upon the fact that the government is responsible directly to Parliament, and represents the majority in Parliament, is absolutely impossible in this country because we have conserved the principle of absolute separation of the executive from the legislative departments. We have at one time or another in a half-hearted way, in the federal government, but more often in our state governments, tried a great many different kinds of executive budgets, budgets prepared by executive departments. I suppose it is safe to say that something like twenty-five hundred of them have been submitted during the last one hundred years, and to assume that ten of them were passed is to make a liberal estimate. To say that as many as one hundred of them had any considerable influence would also be an exaggeration. Most of them are forgotten. Many of them were never read.

Under our system of separating the executive from the legislative department in the United States, the executive department is effective only so long as the governor or the president has a majority in the legislative department which will vote as he directs. A legislative budget is an unreality because a congressional committee cannot have the proper facilities for obtaining the information which it requires. We really must go farther if we are to accomplish the desired results. There are two things to be aimed at through the movement that is commonly called the Budget Movement. One is to bring about economy in expenditures. To determine whether any particular line of expenditure shall be taken up or not, is outside the province of any budget-making body. That matter rests in the hands of Congress entirely. But after the general policy of expenditure has been specified, economy may be brought about, and the wisdom of the proposed detailed expenditure of each dollar or of each larger sum authorized by Congress may be scrutinized through a sound budgetary system.

Our states have shown the way through their boards of control, which in many states have developed so large a body of knowledge and experience that the legislatures very naturally turn to them for further information and rely upon them in making further appropriations. We have an example of how the central idea of that method may be carried out in the federal government in the case of

the reorganization of our old pension system some years ago, when rules were laid down as to the conditions under which pensions should be granted, and Congress kept its hands off from interfering with the individual details.

The second purpose of a budget is a better supervision of the revenue system. As to the general principles of taxation, Congress alone must decide, but as to the administration, the carrying out of any type of tax, we need more expert guidance than we are now getting. In fact, the actual administration of the taxes we now have has, upon the frank avowal of the Treasury Department, broken down and ceased to be effective. Our Income Tax, we are told by the Treasury Department itself, could be made to bring in vast sums in back taxes, and could certainly be made to yield more without change of rates or other essential change in form, if the government had an effective administration. Such an administration could also advise Congress in the present perplexing situation, where we need to have additional revenues to make our budget not merely a balanced budget, but one that shall leave a goodly surplus each year for the reduction of our debt. In the debt itself we have a bottomless pit into which we can pour any surplus revenues for a number of years to come.

Great Britain has gone about this matter in a much more systematic way than we have. Almost immediately after the war she appointed a Royal Commission to investigate the entire subject of the Income Tax. That Commission has just reported.

If we set our own house in order, if we bring our federal finances into proper shape, we shall be able to stop one of the most important possible sources of inflation, namely the continued borrowing for public purposes.